

# Quarterly indirect tax update

October 2017

Welcome to the first edition of our quarterly indirect tax update. In this edition, our team discuss key indirect tax issues in relation to determining the VAT rate on certain foods, common pitfalls from a Relevant Contracts Tax (RCT) perspective and the correct operation of the margin scheme for low-value goods.

## VAT and food

Most of us will be aware that the zero rate of VAT broadly applies to basic food products however, as with all things VAT there are several exceptions to this general rule, for example bakery, snack, savoury and confectionery products which in most cases attract a positive rate of VAT. In this regard even though VAT was introduced in Ireland from 1 November 1972 there continues to be much debate and litigation around food products, particularly products launched in recent years and whether that product can fall within any of the exceptions. Some of the salient considerations include, how terms such as “bakery”, “confectionery” etc. may or may not be defined under VAT law, whether a definition is provided under food law, how a product is manufactured and held out for sale or advertised.

Take for example a basic food item such a bread or what the ordinary person on the street would presume is bread, therefore attracting VAT at the zero rate.

Under VAT law, bread is defined and may only have certain permitted ingredients that must not exceed the specified weight limits. Where the particular product conforms with the VAT definition the zero rate of VAT applies otherwise the reduced rate of VAT, currently 13.5% will most likely be applicable. Bread ingredients for VAT purposes include sugar, fat, dried fruit, bread improver, etc.

Another area of continued debate is the point that was litigated in the ‘Jaffa Cake’ case, ie whether a ‘Jaffa Cake’ is a biscuit or cake. In that case it was ultimately held that a ‘Jaffa Cake’ was a cake for VAT purposes, however to reach that conclusion the court deliberated whether, a ‘Jaffa Cake’ had similar ingredients to a cake, the texture of a ‘Jaffa Cake’ was similar to a sponge cake, the product hardened when stale in the manner of a cake, etc.

From an Irish VAT perspective generally a cake being a flour or egg based bakery product is subject to VAT at the reduced rate, currently 13.5%, which is also the VAT rate applicable to non-chocolate covered biscuits. However, a biscuit which is wholly or partly covered, decorated with chocolate or some other product similar in taste and appearance is liable to VAT at the 23% VAT rate. When determining whether a particular product is a biscuit or a cake, it is indicated that the moisture content of a biscuit is no more than 12% while over that value is considered a cake.

In summary, when businesses are launching a new product or reviewing the VAT rate applicable to an existing product it is important to consider a number of details, as a substantial VAT liability may accumulate over time with one decision. It is also advisable to review VAT rates regularly.



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## Relevant Contracts Tax (RCT) - Items included in contracts which do not fall within relevant operations

A property developer engages a contractor to build residential accommodation which will be sold to investors for rental purposes. As part of the building contract the contractor is to furnish the units, ie white goods and furniture. The RCT and VAT implications of this need to be considered carefully as the penalties for getting it wrong can be punitive for the property developer.





### Issue

RCT applies to construction, forestry and meat processing operations as defined in Section 530 TCA 1997. However, it will also apply to other payments made under a relevant construction contract for matters such as the provision of fittings and furniture.

There is an obligation for the principal, the property developer in our particular example, to also notify such payments to Revenue to obtain the appropriate deduction authorisations prior to making the payments to the subcontractors.

Failure to do so can leave the principal exposed to penalties which are calculated by reference to the amounts paid to the subcontractors, even in situations where the subcontractor has been allocated the 0% rate of RCT by Revenue.

Rate of penalty based on the payments made by the principal:

-  Subcontractor who has been allocated the 0% RCT rate by Revenue.
-  Subcontractor who has been allocated the 20% RCT rate by Revenue.
-  Revenue have determined that the 0% or 20% RCT rate does not apply, so the 35% rate applies as a default.
-  Revenue have not determined a lower rate for subcontractor so the 35% rate applies as a default.

It is also necessary to consider the VAT treatment of supplies such as the white goods and the furniture. They do not come within the scope of the VAT reverse charge, as they do not fall within the definition of construction operations for RCT purposes. Therefore they should be invoiced by the subcontractor as a normal supply with the appropriate VAT rate on the invoice. White goods and furniture are subject to VAT at 23%. The VAT inclusive figure should be provided to Revenue when the principal is applying for the RCT deduction authorisation.

### Potential solution when drafting contracts

The RCT obligations set about above do not apply where the obligation to provide the non-construction operations, eg the loose fittings, are covered by a contract other than the relevant contract. Of course where the contractor has a 0% RCT rate the issue does not arise, but to avoid it having application in other situations our suggestion is to put in place a separate contract to deal with matters which do not come within construction operations.



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## VAT and the margin scheme

The Irish VAT legislation surrounding the margin scheme is provided for in section 87 of the VAT Consolidation Act 2010 (VAT Act) and was introduced to reduce the possibility of double taxation in the context of the sale of second-hand goods. The use of the margin scheme is at the option of the supplier. It can apply to the sale of second-hand goods by a supplier where the sale to the supplier falls within one of the following. The sale was by:

- a person who was not entitled to recover any of the VAT incurred on the purchase, intra-community acquisition or importation of the goods, eg a private individual or a business carrying out VAT exempt activities; and
- taxable dealer<sup>1</sup> in another EU member state who has applied the margin scheme on the sale of the second-hand goods to a business in Ireland.

If the option to apply the margin scheme is not utilised, the 'normal' VAT rules will apply, ie Irish VAT at the appropriate rate is chargeable on the selling price, instead of on the margin.

The margin scheme operates by allowing taxable dealers to pay VAT on the difference between the sale price and the purchase price of the goods:

Sale price of used good	€800
Purchase price of used good	€500
Margin	€300
VAT payable <sup>2</sup>	$(€300 \times 23)/123 = \mathbf{€56.10}$

The VAT payable by the supplier in the above example is €56.10. The margin is a tax-inclusive amount.

It should be noted that in the event that the sales price of the second-hand good is less than the purchase price, the margin is regarded as being nil and there is no VAT due on the sale. In such circumstances, the business is not entitled to a refund of VAT in respect of the loss nor can the loss be offset against profits from other transactions.

Sale price of used good	€800
Purchase price of used good	€900
Margin	NIL

VAT payable = **zero (not applicable)**

## Entitlement to VAT input credit

A business is not entitled to claim an input credit for any VAT included in the purchase of margin scheme goods. However, the business may be entitled to the recovery of input VAT incurred on other goods and services used to make the sales of the used goods, subject to the normal VAT recovery position of the business. Examples would include VAT on rent, utilities and professional services.

## VAT invoicing requirements

When the business issues an invoice in respect of the sale of a used good under the margin scheme, the invoice must not show VAT separately. Any such invoice should include the following narrative, 'Margin scheme, this invoice does not give the right to an input credit of VAT'.

## VIES

VIES reporting requirements **do not** apply to sales under the margin scheme.

## Intrastat

Intrastat reporting requirements **do not** apply to sales under the margin scheme.

## Simplified arrangements for low-value goods (globalisation)

There are simplified arrangements, known as globalisation, for the calculation of the margin which must be applied to low-value goods, where the purchase price of each individual item is **less than €635**. Where the criteria are met, globalisation is mandatory under Irish VAT legislation (section 87(8) of the VAT Act) and as such, no application to Revenue is necessary.

Where globalisation applies, the business should account for VAT on their global profit margin, ie the difference between the value of sales and purchases of all low-value margin scheme goods at each VAT rate in each taxable period.

There is an important difference between the normal margin scheme rules and treatment allowed for special simplified arrangements for low-value goods, ie globalisation).

When the globalisation treatment is applied and the total purchases exceed the sales in any taxable period, the business **is not entitled** to a refund of VAT nor should the deficit be set off against any other liability for that period. However, the negative margin can be carried forward and added to the purchases of low-value margin scheme goods in calculating the global margin for the next taxable period.

Please contact us for further information in this regard, particularly if you have concerns regarding the appropriate VAT treatment where globalisation applies.

## Distance selling

Finally, sales under the margin scheme should be differentiated from distance sales to private individuals, eg mail order sales. Under section 30 of the VAT Act, the place of supply of distance sales is where the dispatch or transportation begins, unless the turnover from distance sales in the country of destination exceeds a certain threshold, eg £70,000 in the UK. In that case, the VAT arises in the country of destination.

Under the margin scheme, **the VAT arises in the country of origin in all cases.**



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<sup>1</sup> Taxable dealers are defined in section 87 of the VAT Act as "persons who deal in margin scheme goods, either on their own behalf or on commission for others."  
<sup>2</sup> Assuming the VAT rate applicable to the goods is 23%.